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REFLECTIONS ON THE SECURITIES BROKER AS A FIDUCIARY

*Norman S. Poser**

ALAN Bromberg and I were colleagues for many years. We entered Harvard College together just when World War II was ending. Many years later, SMU Law School, I believe at Alan's urging, invited me to join its faculty. Though I declined because of family reasons, I recall with pleasure Alan's gracious hospitality when I was in Dallas, and his comfortable living room, filled with Native American artifacts. I should also mention that Alan and Lew Lowenfels are the co-authors of a magisterial treatise on securities and commodities fraud. It is only fitting that this short article, written in Alan's memory, should focus on the protection of investors.

The Dodd-Frank Act (Dodd-Frank or the Act), enacted by Congress in 2010, gives the Securities and Exchange Commission (the SEC or the Commission) authority to adopt rules requiring securities brokers to act in the best interest of their retail customers when giving them personalized investment advice about securities.¹ In Dodd-Frank, Congress left it up to the SEC whether to require broker-dealers to act as fiduciaries. Although Representative Barney Frank, one of the two sponsors of the bill, announced: "we expect them [the SEC] to impose greater fiduciary responsibilities on [broker-dealers],"² the SEC has failed to do so. As of September 2015, nearly five years have passed since the passage of the Act, and the SEC has not yet proposed any such rules. The purpose of this short article is to examine the concept of fiduciary duty as applied to broker-dealer firms, to inquire into the reasons for the Commission's inaction, and to suggest what should happen in the future.

When Congress considered the legislation that became Dodd-Frank, it heard testimony concerning numerous abuses by securities brokers and dealers, including situations where "[f]or at least two years, the largest broker-dealer firms made a practice of betraying their customers by pub-

* Professor of Law Emeritus, Brooklyn Law School. I thank James A. Fanto and Susan Poser for their helpful comments on a draft of this article; however, the opinions expressed, and any errors, are my own. I gratefully acknowledge the research assistance of John Garcia, a member of the graduating class of 2015 at Brooklyn Law School.

1. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(g), 124 Stat. 1376 (2010) (codified as amended in scattered titles of the U.S.C.).

2. 156 CONG. REC. H5212-03 (daily ed. June 30, 2010) (statement of Rep. Frank), available at 2010 WL 2605428.

lishing tainted research reports, apparently without the SEC noticing.”³ In Section 913(g), Congress focused on the difference between the standard of conduct applicable to investment advisers and to broker-dealers, although both categories of securities professionals engage in the same type of business activity: giving investment advice to customers about securities.

Most investment advisers are required to register with the SEC under the Investment Advisers Act of 1940.⁴ As long ago as 1963, the Supreme Court held that investment advisers have a fiduciary relationship with their clients. The Court stated that the 1940 Act “reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship, as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which is not disinterested.”⁵

Broker-dealer firms are not subject to any such fiduciary standard under the federal securities laws. Most broker-dealers must register with the SEC under the Securities Exchange Act of 1934 (the “Exchange Act”).⁶ They are prohibited from engaging in fraud or manipulation,⁷ and they are subject to the rules of the federally authorized self-regulatory organizations (SRO).⁸ The SROs, the most important of which is the Financial Industry Regulatory Authority (FINRA), regulate the ethical practices of their members.⁹ Most broker-dealer firms are required to be FINRA members. FINRA requires its members and their sales forces, among other things, to observe ethical practices,¹⁰ requires them to know

3. *Financial Crisis Inquiry Commission: Hearing Before the S. Financial Crisis Inquiry Commission*, 110th Cong. (2010) (statement of Denise Voigt Crawford, President, North American Securities Administrators Association, Inc.), available at 2010 WL 125994. For a description of many of the abuses that led to enactment of the Dodd-Frank Act, see Norman S. Poser, *Why the SEC Failed: Regulators Against Regulation*, 3 BROOK. J. CORP. FIN. & COM. L. 289 (2009).

4. Section 202(a)(11)(C) excludes from the definition of “investment adviser” “any broker or dealer whose performance of [investment advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11)(C) (2013).

5. SEC v. Capital Gains Research, 375 U.S. 180, 190–91 (1963). In some respects, broker-dealers are regulated more extensively than investment advisers. For example, there is no self-regulatory organization regulating investment advisers, as there is for broker-dealers. For a detailed comparison between the regulation of the two classes of securities professionals, see James S. Wrona, *The Best of Both Worlds: A Fact-Based Analysis of the Legal Obligations of Investment Advisers and Broker-Dealers and a Framework for Enhanced Investor Protection*, 68 BUS. LAW. 1 (2012).

6. Exchange Act, § 15, 15 U.S.C. § 78o (2012).

7. Exchange Act, §§ 9(a), 10(b), 15(c), 15 U.S.C. §§ 78i(a), 78j(b), 78o(c) (2012).

8. Exchange Act, §§ 6, 15A, 19, 15 U.S.C. §§ 78f, 78o, 78s (2012).

9. In FINRA-operated arbitrations, breach of fiduciary duty is the most common claim asserted by customers of brokerage firms. NORMAN S. POSER & JAMES A. FANTO, 2 *BROKER-DEALER LAW & REGULATION* 16-9 (4th ed. 2011).

10. FINRA Rule 2010 provides: “A member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.” FINRA R. 2010, *Standards of Commercial Honor and Principles of Trade*, FINRA (2015),

the essential facts about their customers,¹¹ and prohibits them from recommending unsuitable securities to a customer.¹² While FINRA exercises an important regulatory function, it is subject to a significant limitation: because it is not an arm of the government, it lacks subpoena power and therefore cannot compel the production of essential testimony and documents by non-members, including persons outside the securities industry.¹³ Furthermore, since FINRA and other SROs are membership organizations (though FINRA is administered by full-time officers and employees), there is a potential tension between the interests of their memberships and the regulatory role of the SRO. As a result, SROs are sometimes less than diligent in regulating their members.¹⁴

Although the Exchange Act gives the SEC authority to regulate many of the activities of brokerage firms, including short selling,¹⁵ the handling of customers' cash and securities,¹⁶ and financial responsibility,¹⁷ it does not give the SEC any express authority to regulate the conduct of brokers in dealing with their customers. Nearly forty years ago, Professor Louis Loss of the Harvard Law School, as the Reporter for a Federal Securities Code sponsored by the American Law Institute, proposed to fill this regulatory gap. The Code, drafted over a period of eight years, was designed to be a uniform statute that would replace the five principal securities laws, but it was never enacted. Nevertheless, Professor Loss's proposal regarding the regulation of brokers' conduct is instructive. The Code would have given the SEC the authority to adopt rules prohibiting any conduct by a broker, dealer, or investment adviser "that constitutes unfair dealing with a customer, client, or subscriber."¹⁸ A Note explained that the purpose of this provision was "to carve out a degree of misconduct that is more than 'unethical,' so that it is within the proper sphere of direct regulation rather than self-regulation, but less than 'fraudulent.'"¹⁹

available at http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=5504.

11. FINRA Rule 2090 provides in part: "Every member shall use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer." FINRA R. 2090, *Know Your Customer*, FINRA (2015), available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9858.

12. FINRA Rule 2111(a) provides in part: "A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile." FINRA R. 2111(a), *Suitability*, FINRA (2015), available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859.

13. NORMAN S. POSER AND JAMES A. FANTO, 1 *BROKER-DEALER LAW & REGULATION* 4-8 (4th ed. 2011).

14. For a rundown of regulatory failures by SROs, see *id.* at 4-10 to 4-15.

15. Exchange Act, § 10(a), 15 U.S.C. § 78j(a) (2012).

16. *Id.* §§ 8, 15(c)(2), 15 U.S.C. §§ 77h, 78o(c)(2) (2012).

17. *Id.* § 15(c)(3), 15 U.S.C. § 78o(c)(3) (2012).

18. AMERICAN LAW INSTITUTE, FED. SEC. CODE § 915 (Proposed Official Draft 1978).

19. *Id.* at Note 1.

The SEC has made efforts, not altogether unsuccessfully, to fill the regulatory gap between fraud and unethical conduct by expanding its definition of fraud. Early in its eighty-year history, the Commission developed the theory that every broker, when he hangs out his shingle (i.e., enters the securities business), makes an implied representation that he will deal fairly with his customers and in accordance with the standards of his profession. Thus, any unfair dealings constitute a fraud because they violate this implied representation. Although some courts adopted the so-called "shingle theory,"²⁰ its continuing validity has been questioned.²¹

A second theory that the SEC developed to fill the regulatory gap between antifraud rules and SRO rules became known as the "agency theory." The SEC found that, where a customer had placed his trust and confidence in the broker-dealer to act primarily for the customer's benefit, an agency relationship existed between them, and the broker-dealer had a duty to disclose its adverse interest in the transaction. Thus, the SEC attempted to establish that a breach of fiduciary duty constituted a fraud.²² Like the shingle theory, the agency theory was upheld by the lower federal courts,²³ but it is questionable whether today's Supreme Court, which is generally hostile to implied liabilities, would be willing to stretch the concept of fraud to include a breach of fiduciary duty.²⁴ As a result, there are few, if any, modern decisions by federal courts finding a broker-dealer or its employee liable based on either the shingle theory or the agency theory.

The authority given to the SEC by Section 913(g) of the Dodd-Frank Act requires brokers and dealers to prefer their retail customers over themselves and may be seen as an attempt by Congress to fill, at least partially, the regulatory gap in the securities laws and to create a uniform standard of conduct that would apply both to broker-dealers and to investment advisers. In the congressional hearings and debates leading up to enactment of the Dodd-Frank Act, several witnesses and legislators stressed the need for a uniform standard.²⁵ It was also pointed out that many investors did not know the difference between an investment adviser and a broker, that the legal distinction between them was confusing to investors, and that many investors thought that brokers already had a

20. *Charles Hughes & Co. v. SEC*, 139 F.2d 434, 437 (2d Cir. 1943).

21. In *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 162 (2008), the Court suggested that the scope of federal securities fraud may actually be narrower, not broader, than common law fraud. See also Roberta Karmel, *Is the Shingle Theory Dead?*, 52 WASH. & LEE L. REV. 1271 (1995).

22. The SEC held that broker-dealer rendering investment advice to a retail customer is a fiduciary not only when it acts as an agent for the customer, but also when it sells securities to the customer as principal. *Opper v. Hancock Sec. Corp.*, 250 F. Supp. 668, 674, 676 (S.D.N.Y.), *aff'd*, 367 F.2d 157 (2d Cir. 1966).

23. *Id.* at 672-73; *Hughes v. SEC*, 174 F.2d 969, 971, 975 (D.C. Cir. 1949).

24. See, e.g., *Stoneridge*, 552 U.S. at 148; *Alexander v. Sandoval*, 532 U.S. 275 (2001).

25. See *Commodity Exchange Changes: Hearing Before the H. Comm. on Agric.*, 110th Cong. (2010) (testimony of Hon. Gary Gensler, Chairman, Commodity Futures Trading Commission), available at 2010 WL 893874; 155 CONG. REC. E2970-01 (daily ed. Dec. 9, 2009) (speech of Rep. Melancon), available at 2009 WL 4729817.

fiduciary relationship with their customers.²⁶

Many organizations supported the imposition of a fiduciary duty on broker-dealers.²⁷ A senator stated: "There are not many that continue to oppose imposition of a fiduciary duty. Insurance agents and the insurance industry remain among the few that oppose this investor protection."²⁸ Adverting to the fact that the country was in a recession brought about, at least in part, by the misconduct of securities professionals, one senator stated that a full economic recovery could not be expected without restoring the public's trust in the securities markets.²⁹

Section 913(g) of the Dodd-Frank Act does not impose any new duties on broker-dealers. Nor does it require the SEC to take any regulatory action. Instead, it states that the SEC *may* adopt rules requiring broker-dealers, when providing personalized investment advice about securities to retail customers, to "act in the best interests of the customer without regard to the financial other interest of the broker-dealer."³⁰ The rules, if adopted by the SEC, must also provide that the standard of conduct applicable to broker-dealers "shall be no less stringent than the standard applicable to investment advisers" under the Investment Advisers Act.³¹ Section 913(g) assures broker-dealers that the receipt of compensation based on commissions (the typical form of compensation paid to brokerage firms by retail customers) "shall not, in and of itself, be considered a violation of such standard" ³² It also provides, "Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities."³³

26. 156 CONG. REC. S5870-02 (daily ed. July 15, 2010) (statement of Sen. Akaka), available at 2010 WL 2788025; 156 CONG. REC. H5233-01 (daily ed. June 30, 2010) (statement of Sen. Kanjorski), available at 2010 WL 2605437; 156 CONG. REC. S4034-02 (daily ed. May 20, 2010) (statement of Sen. Kaufman), available at 2010 WL 2010614.

27. The organizations mentioned included the American Associations of Retired Persons, Consumer Federation of America, North American Securities Administrators Association, National Associations of Secretaries of State, National Governors Association, National Association of Personal Financial Advisers, Council of Institutional Investors, and Financial Planning Association. CONG. REC. S4034-02.

28. *Id.*

29. *Id.*

30. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913(g), 124 Stat. 1376, 1828, 15 U.S.C. § 80b-11 (2010).

31. *Id.*

32. *Id.*; Brokers' compensation in the form of commissions is a conflict of interest that is embedded in the securities industry. Broker-dealers and their representatives who handle customers' accounts get paid only if the customer makes a transaction. Under this compensation system, "few brokers are immune to the temptation to consider their financial interest from time to time while they are advising clients. Being at once a salesman and a counselor is too much of a burden for most mortals." Albert Haas, *Let's Put Brokers on a Straight Salary*, N.Y. TIMES, Sept. 4, 1977, at 12, quoted in Norman S. Poser, *Options Account Fraud: Securities Churning in a New Context*, 39 BUS. LAW. 571, 573 (1984).

33. Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 80b-11. The last sentence quoted above in the text appears to be designed to preserve the common law of several states, which holds that a broker for a customer's nondiscretionary account normally does not have a continuing duty to monitor the account. See *Caravan Mobile Home Sales, Inc. v. Lehman Bros. Kuhn, Loeb, Inc.*, 769 F.2d 561, 567 (9th Cir. 1985); *Leib v.*

The scope of the SEC's rulemaking authority under Section 913(g) is expressly limited to investment advice given to retail customers, and a retail customer is defined as "a natural person, or the legal representative of such natural person, who . . . receives personalized investment advice about securities from a broker, dealer, or investment adviser; and . . . uses such advice primarily for personal, family, or household purposes."³⁴ Thus, Dodd-Frank implicitly denies the SEC the authority to require brokers to act as fiduciaries when giving investment advice to their institutional clients, such as churches, personal trusts, credit unions, college endowment funds, foundations, school districts, and state and local governments, as well as mutual funds and pension funds of all sizes.³⁵

Under the well-established common law, "unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency."³⁶ An agent is subject to certain duties of care and loyalty that "go beyond mere fairness and honesty; they oblige him to act to further the beneficiary's best interests."³⁷ In the famous words of Justice Benjamin Cardozo:

Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties . . . Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.³⁸

A securities broker typically performs several different kinds of services for his customer, even within the confines of a single transaction, requiring the broker to exercise his duties of care and loyalty to the customer. The broker may give the customer investment advice, execute the transaction for the customer, complete the transaction through the clearing and settlement mechanism, act as custodian of the customer's funds and securities, and provide credit to the customer for the purchase of securities. Seen against the broad range of activities engaged in by broker-dealers on behalf of their customers, the scope of Section 913(g) of Dodd-Frank is limited. It gives the SEC regulatory authority with respect to only one of these brokerage functions, the providing of investment advice, and then only to the providing of advice to retail customers, i.e., customers who are natural persons. Within these limits, if the SEC chooses to exercise the authority given to it by Section 913(g), the standard of conduct applicable to broker-dealers must be the same as the fiduciary standard applicable to investment advisers.

Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 953 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981).

34. Dodd-Frank Act, § 913(g)(2).

35. See Norman S. Poser, *Liability of Broker-Dealers for Unsuitable Recommendations to Institutional Investors*, 2001 B.Y.U. L. REV. 1493, 1503 (2001).

36. RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

37. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 882 (1988).

38. *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928).

The importance of requiring brokers to place their customers' interests above their own interests is manifest when one considers the potential for abuse, as well as the history of abuse, in the broker-customer relationship. The broker is likely to possess (or have access to) information about companies and the markets that is not available to the customer. It is safe to say that brokers, in seeking business, hold themselves out as experts in giving their customers investment advice. That is their calling card. A retail customer, by the very act of seeking advice, indicates that he likely lacks the ability, background, or training to evaluate investment advice given to him by his broker, thereby making the customer dependent on the broker. This dependence itself is enough to justify the imposition of fiduciary duties on the broker.

Under the fiduciary standard, the broker would be under a duty to disclose to his customer all information relevant to the transaction, which may include such information as the following: that the broker has taken a position in a stock he is recommending; that he is in possession of adverse information about the issuer of such stock; that he is receiving a special commission for recommending the stock; that there is a degree of risk of buying the stock; or that he has not investigated the stock before recommending it.

State law differs as to the circumstances under which a broker is considered to be his customer's fiduciary. The clear weight of authority is that where a broker has discretionary authority to buy and sell securities for his customer's account, the broker is in a fiduciary relationship with the customer.³⁹ In some jurisdictions, a broker is not a fiduciary *unless* the customer has given him discretionary authority.⁴⁰ In other jurisdictions, the existence of a fiduciary relationship may depend on one or more of several factors, including: whether the broker exercises control over the account;⁴¹ whether there is a long-standing relationship between the broker and the customer;⁴² the investment sophistication of the customer;⁴³ whether the customer reposed trust and confidence in the broker;⁴⁴ the complexity or riskiness of the securities traded;⁴⁵ or whether the customer relied on a third party for investment advice.⁴⁶ The differences among the states on the nature of the relationship between broker and customer makes the need for a federal rule all the more imperative.

While giving the SEC the authority to require broker-dealers to act as fiduciaries when giving personalized investment advice to retail custom-

39. *McAdam v. Dean Witter Reynolds, Inc.*, 896 F.2d 750, 766 (3d Cir. 1990).

40. *Carr v. CIGNA Sec., Inc.*, 95 F.3d 544, 547 (7th Cir. 1996).

41. *Newitt v. First Union Nat'l Bank*, 607 S.E.2d 188, 196 (Ga. 2004).

42. *Flickinger v. Harold C. Brown & Co., Inc.*, 947 F.2d 595, 597, 599 (2d Cir. 1991).

43. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng*, 697 F. Supp. 1224, 1226 (D.D.C. 1988).

44. *DeRance, Inc. v. PaineWebber, Inc.*, 872 F.2d 1312, 1321 (7th Cir. 1989).

45. *Arthur Joseph Lewis*, Exchange Act Release No. 34-29794, 49 SEC Docket 1487 (Oct. 8, 1991), *available at* 1991 WL 294317.

46. *David K. Lindemuth Co. v. Shannon Fin. Corp.*, 660 F. Supp. 261, 265 (N.D. Cal. 1987).

ers, Dodd-Frank also ensured Commission delay, by requiring it to conduct a detailed study of the subject, to seek public comment, and to report back to Congress within six months.⁴⁷ The SEC staff conducted such a study and, after receiving over 3,500 comments from members of the public, wrote a report with recommendations to the Commission.⁴⁸ Unsurprisingly, the many investment advisers who submitted comments favored rules that would subject broker-dealers to the higher standards of conduct already imposed on investment advisers. In January 2011, six months after the enactment of Dodd-Frank, the SEC staff submitted a report to the Commission, recommending that the SEC establish a uniform fiduciary standard for investment advisers and broker-dealers when providing investment advice to retail customers.⁴⁹

Another two years went by before the Commission took any action, and then it was again to solicit comments from the public.⁵⁰ The Commission explained this second solicitation was necessary because few commentators provided cost-benefit data.⁵¹ While it is beyond the scope of this article to summarize the many responses received by the Commission to its second solicitation for comments, one stands out for its clarity—and for its demand for clarity—from the SEC: an individual who identified himself as a registered representative with a firm that was both an investment adviser and a broker-dealer wrote: “I encourage you at the SEC to demonstrate some real backbone and thus lead on this matter to adopt a COMMON FIDUCIARY STANDARD FOR THE FINANCIAL SERVICES INDUSTRY.”⁵²

The Securities Industry and Financial Markets Association (SIFMA), the trade organization of the securities industry, which claims to “bring . . . together the shared interests of hundreds of securities firms, banks and asset managers,” wrote to the SEC that it supported a uniform standard, but added that its support “[was] predicated upon appropriate cost-benefit analysis and implementation of the standard in a manner that preserves investor choice, is cost-effective and business model neutral, and avoids regulatory duplication or conflict.”⁵³ Thus, three years after the enactment of Dodd-Frank, and after two requests for public comment to the SEC, the securities industry asked for more study on the subject. And after two more years, the SEC has not, as of September 2015, proposed

47. Wall Street Reform and Consumer Protection Act, 15 U.S.C. § 78o (2012).

48. See U.S. SEC. & EXCH. COMM’N STAFF, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS (2011) [hereinafter “SEC Staff Study”], available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

49. *Id.* at ii.

50. Sec. & Exch. Act Release No. 34-69013, (Mar. 1, 2013), available at <https://www.sec.gov/rules/other/2013/34-69013.pdf>.

51. *Id.* at 8.

52. Sec. & Exch. Act Release No. 34-69013, Comment submitted by Les E. Vicain Jr. (July 1, 2013), available at <https://www.sec.gov/comments/4-606/4606-3095.pdf>.

53. Sec. & Exch. Act Release No. 34-69013, Comment submitted by SIFMA at 1, 24 (July 5, 2013), available at <https://www.sec.gov/comments/4-606/4606-3128.pdf>.

any rules under Section 913(g). If Congress intended to kick the can of fiduciary duty down the street, it succeeded beyond all expectation.

The SEC's apparent reluctance to adopt investor-protection rules that Congress authorized, even if it did not mandate, is not easy to explain. The idea that a broker should prefer his customers' interests over his own interests seems like a no-brainer. SEC Chair Mary Jo White stated publicly in March 2015 that it was her "personal view" that the SEC should implement the uniform fiduciary standards authorized by Dodd-Frank.⁵⁴ Yet Chair White added, "You have to think long and hard before you regulate differently."⁵⁵ A month earlier, President Barack Obama placed the prestige of the White House squarely behind the notion that broker-dealers are fiduciaries, when he publicly called on the Department of Labor to "update the rules and requirements that retirement advisors put the best interests of their clients above their own financial interests It's a very simple principle. You want to give financial advice, you've got to put your client's interests first. You can't have a conflict of interest."⁵⁶ Shortly afterwards, the Labor Department released a proposed rule for public comment, which would impose fiduciary duties on broker-dealers handling retirement accounts.⁵⁷

The SEC's inaction may be due to a subtle, but fundamental, shift in the agency's view of its mission. Throughout much of its history, the Commission has seen its purposes to be investor protection and the maintenance of honest securities markets. In 1944, ten years after it was established, the SEC stated that the enactment of the securities laws was a response to "a need for legislation that would curb financial malpractice and require those using and soliciting the use of other people's money to conform at least to the minimum standards of fiduciaries or trustees – all to the end that investors might be protected and the public interest furthered."⁵⁸ Fifteen years later, the SEC stated that the securities laws "fundamentally aim to require that those who deal with the investments of the American people observe high standards of conduct."⁵⁹

54. Justin Baer & Andrew Ackerman, *SEC Head: Raise the Bar for Advisers*, WALL ST. J., Mar. 18, 2015, at C5. Chair White's speech was made at a SIFMA conference in Phoenix, AZ. Contrary to the usual practice, the speech was neither the subject of an SEC press release nor displayed on the SEC website.

55. Peter J. Henning, *SEC Faces Tough Challenge to Enhanced Broker Rule*, N.Y. TIMES DEALBOOK, Mar. 23, 2015.

56. Remarks by President Barak Obama at the AARP Conference (Feb. 23, 2015) (White House Press Release), available at <https://www.whitehouse.gov/the-press-office/2015/02/23/remarks-president-aarp>.

57. US Labor Department seeks public comment on proposal to protect consumers from conflicts of interest in retirement advice (Apr. 14, 2015) (United States Department of Labor News Release), available at <http://www.dol.gov/opa/media/press/ebsa/EBSA20150655.htm>.

58. SEC. & EXCH. COMM'N, TENTH ANNUAL REPORT: A TEN YEAR SURVEY 1934-1944, at 2 (1944).

59. SEC. & EXCH. COMM'N, A 25 YEAR SUMMARY OF THE ACTIVITIES OF THE SECURITIES AND EXCHANGE COMMISSION 1934-1959, at xiii (1949).

In recent years, the SEC has added a new element to the statement of its mission. The SEC website in 2015 states: "The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and *facilitate capital formation* The common interest of all Americans in a growing economy that produces jobs, improves our standard of living, and protects the value of our savings means that all of the SEC's actions must be taken with an eye toward promoting the capital formation that is necessary to sustain economic growth."⁶⁰

It cannot be said that the SEC added capital formation to its stated mission entirely on its own initiative. Congress has shown itself willing to reduce investor protection in order to stimulate the economy. In 2012, in the midst of the Great Recession, Congress enacted The Jumpstart Our Business Startups Act, known as the JOBS Act.⁶¹ The JOBS Act exempts certain new offerings of securities from the registration requirements of the Securities Act of 1933 and enlarges certain other exemptions from the securities laws. Its stated purpose is "to increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies."⁶² But despite Congress's focus on capital formation in this instance, it has never added capital formation to the statutory mission of the SEC. To do so would have pernicious consequences. If capital formation were to be regarded as an independent goal of the SEC, it would be easy for the SEC to take the next step and conclude that protection of investors should be sacrificed to promote capital formation.

In fact, the Securities Exchange Act of 1934 (the "Exchange Act"), which regulates broker-dealers, expressly links regulation of the securities markets to the general economic welfare of the nation, but it does so in a very different way. Section 2 of the Exchange Act states that transactions in securities are "effected with a national public interest which makes it necessary to provide for regulation and control of such transactions . . ." and that "such transactions . . . constitute an important part of interstate commerce"⁶³ Section 2 goes on to say that the prices of securities traded on the exchanges and the over-the-counter markets are susceptible to manipulation, and that "sudden and unreasonable fluctuations" in securities prices can have a deleterious effect on the availability of credit, the federal and state tax systems, and the banking system.⁶⁴ Most important, Section 2 states that such misconduct in the market causes "national emergencies, which provide widespread unemployment and the disloca-

60. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM'N, available at <http://www.sec.gov/about/whatwedo.shtml#VSVSLCj7W9Y> (last visited Apr. 8, 2015) (emphasis added).

61. Jumpstart Our Business Startups Act ("JOBS Act"), Pub. L. No. 112-106, 126 Stat. 306 (2012) (previously H.R. 3606, 112th Cong.).

62. *Id.* at Preamble.

63. Exchange Act, § 2, 15 U.S.C. § 78b (2012).

64. *Id.*

tion of trade, transportation, and industry”⁶⁵ Thus, the framers of the Exchange Act made the important point that the regulation of broker-dealers and the markets is *needed to protect* the national economy, not that regulation should be *balanced against* the needs of the economy.

Events that occurred in recent memory illustrate the wisdom of the framers of the Exchange Act seventy-five years earlier. In the first decade of the twenty-first century, massive violations of the securities laws have led to unemployment, poverty, and misery. People who had never participated in the securities markets were affected, along with investors. According to the national commission set up to inquire into the causes of the crisis: “Panic and uncertainty in the financial system plunged the nation into the longest and deepest recession in generations. The credit squeeze in financial markets cascaded throughout the economy.”⁶⁶

The SEC’s failure to adopt rules under Section 913(g) is not surprising, given the increased politicization of the agency. When I was an SEC staff member in the 1960s, it was rare for the Commission to be divided on any issue. Differences of opinion were usually resolved, and formal dissents to Commission actions were almost unknown, even though the Commission is politically divided by statute. The Exchange Act requires that not more than three of the five commissioners be members of the same political party;⁶⁷ in practice, the SEC chair and two other commissioners are members of the same political party as the President and the remaining two commissioners are members of the other party. These days, it is not uncommon for the minority commissioners to dissent from important regulatory decisions, although there have been occasions where the Chair and the two minority commissioners agree and the two majority commissioners dissent. The point is that in recent times, Commission decisions that should be arrived at by considering what best serves the goals of protecting investors and assuring honest and efficient markets are instead treated as political decisions. The extent to which political considerations have been a factor in the Commission’s failure to implement Section 913(g) of Dodd-Frank is impossible to say, but it is a likely surmise.

What lies ahead? One can hope that by the time this article appears in print the SEC will have ruled that broker-dealers and their employees are fiduciaries who must place their customers’ interests ahead of their own. Whether or not this happens, it is time for the President and Congress to

65. *Id.* Section 2 is in the nature of a preamble to the Exchange Act. It may have been inserted as an integral part of the statute because its framers wanted to establish the constitutionality of Act under the Commerce Clause by linking malfeasance in the securities markets to interstate commerce. The only substantive amendment of section 2 since its original enactment is the addition in the 1970s of language relating to the establishment of a national market system and of a national system for the clearing and settlement of transactions.

66. FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, at 389 (JAN. 2011), available at <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

67. Exchange Act, § 4(a), 15 U.S.C. § 78j(a) (2012).

consider the systemic problems within the SEC. One useful step would be for the President to appoint some SEC commissioners who have not spent any substantial part of their careers in partisan politics or as attorneys or officers of firms regulated by the SEC. In the past, a number of academics and long-time SEC staff members have been among the most effective SEC chairs and commissioners.⁶⁸ Another step would be for Congress to make clear that the overarching goal of the SEC is protection of investors and maintenance of fair and orderly markets.

Finally, the culture of the securities business needs to change. For several decades now, brokerage and investment banking firms have derived much of their profit from proprietary trading, which often creates conflicts of interest with the activity of advising retail customers. As the economist Martin Wolf recently put it: "Equally important [with distorted incentives] . . . are behavioral norms, such as the view that the primary duty of bankers is to themselves not their customers."⁶⁹ Legal requirements can have only a limited impact on such a mental attitude. According to another economist: "Responsibility, to the man who feels it, is not made clearer by legal subtleties. If he does not feel it, these legal subtleties are humorously innocuous."⁷⁰ But if that responsibility is not felt, then we must look to the law to instill it.

68. SEC Chairmen and Commissioners whose names come to mind are the academics William O. Douglas, Jerome Frank, William L. Cary, and Harvey Goldschmid; and the longtime staff members Manuel Cohen and Irving Pollack. *SEC Historical Summary of Chairmen and Commissioners*, U.S. SEC. & EXCH. COMM'N, available at: <https://www.sec.gov/about/sechistoricalsummary.htm>.

69. Martin Wolf, *Make Policy for Real, not Ideal, Humans*, FIN. TIMES, Dec. 17, 2014, at 9.

70. ARTHUR S. DEWING, *THE FINANCIAL POLICY OF CORPORATIONS* 81 (5th ed. 1953).